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WORKING GROUP PAPER

ON

TECHNOLOGY TRANSFER POLICY FOR CHINA

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Technology Transfer Policy for China

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Technology Transfer Policy for China

Our export policy toward China must reflect a balance between two competing objectives. On the one hand we desire to develop a strong and enduring relationship with China, which in time seeks to align them more closely with the West. U.S. export policy is a key tool to further this objective. On the other hand there is a legitimate concern that the intended relationship may not mature favorable for the U.S. As a result it is prudent to insure our exports do not contribute in a major way to that portion of China's military capability that if used against us, would pose a major national security risk to ourselves or our allies. The formulation of U.S. export policy to China must therefore contend with the strain caused by these competing concerns, provide the best balance at any one time, and be prepared to adjust as the relationship changes.

Significant difficulties have surfaced with the state of current China export policy and its execuation within the U.S. government. (See Tab A for expanded discussion). Recent Chinese American dialogue makes it imperative we review this policy and move forward from a uniform U.S.G. position. In support of this review our interagency group on China has studied the issues and endorses the adoption of five implementation improvement options shown at Tab B. We further offer for discussion two distinct policy options for future management control of policy and suggest a set of four possible statements to express the level of technology transfer to be permitted.

I. Management Control Policy

Controls on dual-use exports to China, now administered under the Export Administration Act, allow implementation by either National Security or Foreign Policy provisions. By their very nature, these are distinct alternatives. Absent other level setting direction, they provide measurably different foreign policy perception, and technology transfer results. Either control can be implemented with China in group P or V.

National Security Controls

National Security Controls as defined by U.S. EAA law, and as applied to specific countries, requires a Presidential determination that that country is a national security destination. This carries with it the perception that the named country is a potentially significant military threat to the U.S. and/or its allies. Within the Export Administration Act and under this determination, DoD has a special role in implementing the ensuing controls. Should DoD judge that the export of a particular item of equipment or technology would be harmful to national security, it may recommend to DOC that the export be denied. Should this recommendation be challenged, as it often is, the decision is escalated to the cabinet level where the Secretary of Defense has a statutory veto. By law, the Secretary of Defense can only be overridden by the President. If the President decides

to override Defense, he must notify Congress of his action. This has never occurred, in effect giving DoD a de facto veto over licenses to national security destinations. Present U.S. technology transfer policy for China is implemented under National Security Controls. The Department of Commerce is the executive administrator of the process.

Foreign Policy Controls

The adoption of Foreign Policy controls to China exports will require a Presidential declaration to Congress that China is no longer a national security destination. This carries the perception that the PRC is no longer viewed as a significant potential military threat to the U.S. and its allies. Under this control policy, DoD, DoC and DoS would remain fully involved in the licensing process. However, at the Cabinet level the Secretary of Commerce would be the deciding voice. DoD, DoC and DoS, retain the right to appeal any case to the President for a final decision. Unlike national security controls, the President need not inform Congress that he has overruled any Cabinet department in the process. Foreign policy controls do, however, require a declaration and rejustification to Congress by December 31 of each year or expire. This option treats China the same as other non-COCOM controlled destinations. However, in the construct of this paper, the requirement to submit export applications for China to COCOM would remain for the foreseeable future.

II. Technology Transfer Levels

With either control policy option, it is imperative to provide guidance on the level of exports to China. This guidance can take the form of a qualitative declaration or a quantitative statement that attempts to set the level of exports at some single numerical benchmark. Both qualitative and quantitative choices are offered for consideration.

Choice 1. Maintain about the current level of control on exports applicable to the four special mission areas. Relax controls to be equal to other friendly non-aligned countries for items that have little or no application in the four special mission areas.

Choice 2. Approve levels of technology currently available to friendly non-allied nations except for exports applicable to four special missions areas. Define a short negative list of key equipment and technologies with associated levels that would significantly enhance China's capabilities in these mission areas and pose a credible threat to the U.S. or its allies. Items on this list would be treated with a presumption of denial. Define precisely a complete list of items and/or technologies and their associated levels in the special mission areas where controls may apply, depending on end use or other relevant factors to be considered. For all other items there will be a strong predisposition toward approval.

The intent of this option is a substantial liberalization of our export control policy toward China and, in this regard, Defense and Commerce shall seek to substantially expand the delegation of authority given Commerce so that more items may be routinely licensed without referral to DoD.

Choice 3. Set this level at a fixed percent of the generally available world level. Commerce has recommended 75%.

Choice 4. Allow transfer of technology at generally available free-world levels. Those items already controlled to non-COCOM controlled countries would also be controlled to China (i.e., Nuclear weapons and their delivery systems).

III. Discussion

National Security Vice Foreign Policy Controls

Given the basic definition of National Security Controls and Foreign Policy Controls and our history of their application, there is a clear and distinct attitudinal difference of opinion that the U.S. Government conveys to other world governments and our own domestic institutions by the simple act of placing China under one or the other policy. For most observers military security controls are synonymous with a U.S. perception that China is or may likely become a significant military threat to the U.S. and/or its allies by a growth in capability and/or a change of intent. This perception is formed from the words that define National Security Controls; the fact that only the President can overrule Defense and its confined application to the USSR, bloc countries, other non-friendly communist countries, and China.

In contrast, Foreign Policy Controls convey a less distinct, and generally more friendly U.S. Government attitudinal view of the country in question, although foreign policy controls are also used for non-friendly countries. The absence of the declaration of China as a national security destination with all it implies, contributes to this other perception.

What may be more important is the historical application of our policy. We have and do apply Foreign Policy Controls to friendly as well as non-friendly countries and tailor the controls as required. Some NATO allies, as well as countries like India, Yugoslavia, and Libya, are included and treated with wide differentiation. Some, like Libya and Iraq, have very strict controls placed on them; many would say even harsher than those now imposed for China. Despite this mixed history, placing a country under National Security Controls implies that the USG perceives that country as a potential threat.

Clearly, by changing from National Security Controls to Foreign Policy Controls the U.S. would send a major signal concerning our view of China. However, the tone of the message can be significantly moderated by 1) maintaining COCOM controls, which is uniformly recommended in this paper, 2) tailoring the transfer control level through a clearly articulated policy statement that shows our intent and, 3) retaining Defense participation in the review process, albeit without quite as strong a voice. Within this construct, movement of China from country group P to V might also be considered.

A key issue is, what would be the effect of eliminating the situation whereby the President must notify Congress if he

overrules Defense by moving to Foreign Policy Controls? We have recommended that, if Foreign Policy Controls are adopted, Defense should continue to be given the right to review all cases, and participate in all dialogue and cabinet level discussion. If DoD disagreed with the cabinet-level discussions, it would retain the right to appeal the case to the President. The basic difference in this management construct from current practice is that Defense would be forced to clearly show cause why the transfer is a security risk instead of the other departments having to prove why it would not be. Since Defense has the major expertise to know whether or not an item presents a national security risk, it should carry the responsibility to make the case. To depend as we do now, on a process where Commerce or State has to disprove the negative and do so from a position of non-expertise, is to provide in practice a simple Defense veto. If a Defense veto is the desired tool of control, it would be best to say this directly and avoid much interagency dialogue. However, if we adopt foreign policy controls and retain Defense's ability to review all cases and its appeal rights, we believe no grievous breaches of transfer will occur. This change, if adopted, would hopefully result in increased and possibly more consistent technology transfer policy for the PRC.

Technology Transfer Level

To have confidence that our future China technology transfer policy is implemented as intended, it is imperative that a statement be issued that provides guidance as to the general level desired. In the previous material, we have provided examples of both qualitative and quantitative statements that may serve this purpose. The vast majority believe a rigid quantitative guidance statement is not the most appropriate. All but Commerce recommend that quantitative choice 3 not be used, and suggest guidance through choices 1, 2, or 4. Commerce recommends choice 3.

COCOM Concerns

We believe that we can change our export policy towards China in any of the ways described without substantial impact on our broader COCOM objectives. It would, however, have to be done with the full prior knowledge of our COCOM partners and others who have informally supported COCOM initiatives. We would have to explain our reasons for any liberalization, consult with them, and emphasize that we would continue to honor our COCOM obligations. We would emphasize that U.S. internal liberalization of exports to China implied no relaxation of our efforts to tighten COCOM controls on the USSR and other Warsaw Pact nations.

U.S. Demarche to China

If the decision is made to significantly liberalize our technology transfer to China, many argue that this should initially be announced to the Chinese in some form of a demarche. Some also argue that we should use this opportunity to get something from the Chinese in return, or at least let them know we have not taken these steps only because they have complained loudly and often. That would make us look vulnerable to any pressure. In addition, Demarche has the advantage of engaging both parties in a discussion to a common end. We have not attempted to define the details of how this should be accomplished but simply raise it for consideration.

 DECISION

IV. Policy Decisions

Management Control Decision

_____ National Security

_____ Foreign Policy

Technology Transfer Level

_____ 1. Maintain current level

_____ 2. Substantially raise level

_____ 3. Raise to 75% of free world

_____ 4. Raise to free world level

Move China from P to V

_____ Yes _____ No

TAB A

Tab A

Problem Discussion on Technology Transfer Policy for China

Since formal normalization of relations in 1979, the US has gradually liberalized its export control policy toward China. In August 1979, Vice President Mondale told Vice Premier Deng that we were working in COCOM to establish a differential between those commodities which go to the USSR and to China. We then immediately started to approve exports of selected equipment and technologies not previously exportable to China. In March 1980, President Carter directed that China be moved from the same Country Group as the Soviet Union (Group Y) to a unique category (Group P). In September 1980, the U.S. announced that it would no longer automatically deny a license application simply because it was for a military end-use or was of unusually advanced technology.

The Group P categorization was not defined until President Reagan's directive of June 4, 1981. This set the technical level at which there would be a predisposition to approve cases for China at approximately twice that provided to the Soviet Union prior to the invasion of Afghanistan. Also in June 1981 COCOM members informally agreed to a more liberal China export policy vis-a-vis the Soviet Bloc. Formal diferentiation has not been possible because the allies (particularly France and Japan) wish to treat all controlled destinations alike on paper. However,

the allies are also willing to informally agree to differentiate. On May 6, 1982, Judge Clark, on behalf of the President, issued a memorandum reiterating and clarifying the Presidential Directive of June 4, 1981. This set a predisposition for approval of all cases, unless they posed a major risk in one of four special mission areas: anti-submarine warfare, electronic warfare, intelligence gathering and nuclear weapons systems.

Our export policy has attempted to balance two conflicting objectives. On the one hand, we seek to develop a strong and enduring relationship with China. We support Chinese military and strategic development, insofar as they act as a counterweight to Soviet power in Asia. We want China to be a stable and positive actor on the world scene, promoting global and regional security. Over the long term we hope that China will become increasingly integrated into, and aligned with, the West. On the other hand, there is a legitimate concern that our exports not contribute to China's military capability in such a way as to pose a major national security risk to either ourselves or our Asian allies. China is independent of the USSR and a counterweight to Soviet military power, but it is communist. It is vigorously pursuing a nuclear weapons program. It can deliver a limited number of nuclear warheads on the U.S. China reportedly has exported nuclear weapons technology to Pakistan and unsafeguarded nuclear materials to the Third World. Chinese diversions and illegal

acquisitions of U.S. technlogy and their violation of U.S. controls are well documented. Although China supports Asian initiatives concerning Kampuchea, most Southeast Asian countries remain concerned about China as a potential enemy. Taiwan also remains unconvinced by China's current peaceful posture. Much of the advanced technology the Chinese do want is dual-use technology -- it has a benign civilian application but could also have military application if diverted. In certain cases, identical technology is used by both civil and military end users. And, in many cases, civil end users in China are subordinate to military research and development entities.

Aiding in China's modernization through the export of technology is a key element in making China an effective counterweight to growing Soviet military power and strengthening strategic cooperation with China. All of us recognize that the relationship is young, and represents a radical change from the 1950's and 1960's, but it is also clear that the relationship's future is uncertain. As a result, we must take care that our objective of protecting our military interests does not unnecessarily handicap our ability to foster a stable relationship with China.

China is not now our adversary. Nevertheless, it is the only non-adversary nation possessing strategic nuclear capabilities that is not an ally. This, and the fact that our relationship is just over a decade old, argue for prudent controls to guard against the danger that technology provided today might do us serious harm in the future should that relationship change.

Our current policy attempts to reconcile our often conflicting goals by encouraging exports "at significantly higher technical levels than previously, albeit somewhat below those approved for other friendly non-allied countries", while restricting "exports which would make a direct and demonstrable contribution to Chinese capabilities in the four special mission areas. The current policy also has a "two-times" rule of thumb, meaning a "predisposition to approve at a technical level approximately twice that provided to the Soviet Union prior to the Afghanistan invasion."

Thus, we have a dilemma. In practical terms, we want to expand trade with China to help it modernize and to help the U.S. cement a favorable long term relationship. In symbolic terms, China is looking for legitimacy and recognition as a major power, especially from the U.S. But we also seek to minimize the long term risks to our national security by attempting to support China's military modernization in a way which improves their capability against the USSR, but not against the U.S. or its allies.

The problem is not of major proportions in dollar terms. Out of $3.1 billion of 1982 export trade to China, about $0.45 billion required a license. This $450 million represents about 5/6 of the dollar amount of license applications processed.

That is, about 1/6, or $90 million, of the license applications were denied or returned without approval. (Those returned without approval were returned usually for some administrative reason.) Therefore, less than 3% of all trade to China was denied a license. However, this can be a misleading statistic. Some believe that U.S. regulations and multilateral agreements (i.e. COCOM), discourage license applications for technology which would otherwise be proposed for license. Also, because each commodity has its own individual threat potential, statistics are not the most effective way of determing the risk factor in total exports.

The Commodity Control List (CCL) is the most comprehensive aggregation of product listings which identifies products of U.S. strategic concern. Of the 187 CCL entries which potentially pertain to China, ten represent 80% of all license applications, six represent 75%. Two CCLs represent 55% of all license applications, computers 40% and scientific instruments 15%. These last two entries are most frequently the subjects of the hardest to decide cases since they have general utility in the four special mission areas.

Problems With Current Policy

A. Chinese Perceptions

The Chinese have expressed great disappointment with the

availability of U.S. high technology products and processes. It is logical to believe that they expected normalization to produce much greater liberalization of our export policy. Deng Xiaoping has made clear that in exchange for strategic cooperation with the U.S. he expected strong U.S. support in the technology transfer area. He has also made it clear that development of the overall U.S.-China relationship will be strongly affected by U.S. technology transfer policy.

Below Deng's level, the Chinese have said access to dual use technology is critical to their industrial and military modernization. They have pointed out the discord between our often stated policy of "supporting a secure, friendly and modernizing China with which we share strategic interests", and our actual export control policy, which applies an export control procedure used only with adversary nations. They point out that this accords China treatment worse than the US applies to countries like India, which they cite as having much warmer relations and stronger technological ties to Moscow.

We have contributed to raised Chinese expectations about liberalization of our export policy by repeatedly suggesting that exports of various types of advanced technology and equipment might be possible while at times attributing implementation problems to simple bureaucratic inertia. The caveats (legitimate security controls) have often been lost in the positive statements

which have left a strong impression over the past several years of our willingness to make available high technology.

The Chinese also want a clear and decisive U.S. export policy, one which would help them to clearly understand how we want to treat them and also help the US business community know what the ground rules are. This was demonstrated during Secretary Shultz's recent trip to China, when Fang Yi and others stated that it would be most helpful for the U.S. to tell them explicitly what we do not want to make available to them, a very pragmatic approach.

The Chinese also complain about being included in COCOM with the Soviet Union and other Warsaw Pact countries, and about the pegging of the two-times rule to the USSR.

The result as perceived by the Secretary of State, and other senior U.S.G. officials, is that technology transfer ranks only behind Taiwan as an irritant in bilateral US-PRC relations.

B. U.S. Business Perceptions

U.S. business sees itself at a severe competitive disadvantage, in terms of sales opportunities to China vis-a-vis foreign suppliers. Our allies process license applications and submit them to COCOM much more rapidly than we, reflecting a considerably more expeditious export policy toward China by our COCOM partners. U.S. business believes that the Chinese can often get competitive equipment from other suppliers if the U.S. denies a license, although other COCOM-country suppliers must have approval

in COCOM, where the U.S. can deny an item if it poses a security risk. Some U.S. firms simply avoid the China market, claiming they fear refusals of an export license or do not wish to become involved in a complex and lengthy licensing process, that can mean major administrative expenses that are not always realized in profits, and penalty fines for late delivery. However, the only alternative to remove this cost of doing business in China would be to drop all national security controls.

The Chinese also pressure the USG through the business community. They sign contracts which contain performance bonds, dependent on the U.S. company obtaining an export license, for technology exceeding current guidelines. And, even if there is no performance bond, the Chinese often engage in contract discussions for state-of-the-art equipment because they want the best available, sometimes simply it seems, for reasons of prestige. But there is also a fundamental desire to get the best product for the money. Since many US companies view China as a long-term market, they strive to be competitive in China. This manifests itself in pressure on the USG to approve higher and higher levels of technology. License applications for exports to China in early 1983 have increased 150 % above the average rate for 1982. Thus, we may be facing a significantly larger licensing problem than we have in the past.

C. Confusion with Current Policy

There are two areas which cause confusion with current policy. One relates to the level of technology that we are willing to export; the other relates to the four special mission areas.

Technology Level -- The broad statements in the current policy call for "the approval of technology to China at significantly higher technical levels than previously approved, albeit, somewhat below those approved for other friendly non-allied countries." But later in the technical guidelines it is also stated that, "two-times...is to be taken as an indicator of the technical level of products and know-how that imply the presumption of acceptable national security risk..." In many instances these become contradictory statements because precisely "two-times" is often far below the free world level. There are other problems with the "two-times" rule or any other simple quantitative scheme to define acceptable technical levels for exports. For items denied to the USSR, there is nothing to take "two-times" of. A level has independently been set in some cases. For items like computers, many individual technical parameters synergistically determine the system's capability, making direct application

of "two-times" criteria to individual parameters virtually impossible. In other instances doubling the value of a single performance parameter may much more than double overall system performance. For some items, interagency agreement has thus been possible only at levels below the "two-times" criteria. We have also often applied special conditions to approvals that are not normally imposed on cases for most non-controlled destinations, such as periodic on-site inspections.

The guidelines do envision denials to China and recommend that lower risk substitutes be considered where feasible. Defense has often recommended such substitutes. The Defense Department has also granted Delegations of Authority to the Commerce Department for most items which do not require COCOM referral, and in practice few licenses have actually been denied, although many have been modified or delayed in the interagency review process.

But these statistics can be misleading. Many license applications are made expecting approval; companies want to avoid formal denials because of their potential impact on future business with the Chinese. The low percentage of actual denials thus does not

accurately portray the levels of technology being approved vis-a-vis what the Chinese really want. What the Chinese really want in some cases is far above the current level--providing the higher level would require dropping national security controls.

The Four Special Mission Areas -- the technical guidelines state "that unless circumstances apply which entail major risks to national security (i.e., exports which would make direct and demonstrable contribution to Chinese capabilities in nuclear weapons and their delivery systems, electronic and anti-submarine warfare, or intelligence gathering), cases that meet the "two-times" rule of thumb should be approved for sale to China. There should also be a predisposition for approval of cases above the "two-times" level unless the transfer poses a major national security risk in the special mission area." These guidelines can be interpreted to mean that almost any item by definition poses a risk to national security. Extensive debate ensues about what is a "major risk" and what is "direct and demonstrable" in the special mission areas. As written, it is not at all clear why the "two-times" level is even mentioned here because the same criterion seems to apply both below and above it. Finally, the Department of Defense has a statutory veto authority at the Cabinet level on setting the "threshold." This can result in delays at the working and sub-Cabinet level in escalating

problem cases for decision. Taken together, many believe this combination of factors has resulted in inconsistent and often difficult policy application.

The group unanimously agrees that the "two-times" rule has served a useful purpose to date, but that now the rule per-se is no longer an effective benchmark. It should be replaced by a specific China list developed by an inter-agency group guided by a Presidentially endorsed statement of control level intent.

Tab B.

Procedural Improvement Recommendations

During the working group review, several recommendations surfaced which we believe could greatly enhance U.S. execution of the China high technology transfer policy. All of the following recommendations have strong endorsements. Some may require additional resources.

1) Defense should immediately provide DoC a Delegation of Authority (DOA) for cases whose existing technology levels are below current COCOM criterion for general exceptions to the international list of dual-use equipment.

Rationale

This DOA allows DoC to act expeditiously on cases historically approved. This can be implemented almost immediately.

2) DoC in consultation with Dod and DoS should publish within 3 months, and update annually a China technology transfer commodities policy guideline that conveys for each CCL item the level of technology permissible for license approval to China (a "green line") and a level above which there will be a predisposition to deny the license (a "red line"). This policy guide shall be

constructed with the intent of allowing technology transfer within the permissible "green line" level by DoA to Commerce. Above this level, case-by-case reviews including inputs from DoD, DoS, and DoC will be the mechanism for license determination. The organizational administration of the review would remain the same as now. ACEP (the Advisory Committee on Export Policy) would review U.S. cases before they go to COCOM. EDAC (the Economic Defense Advisory Committee) would review foreign COCOM cases and coordinate the U.S. response to foreign actions on U.S. COCOM cases.

Rationale

A published commodities list China policy guide will allow U.S. industries to better determine licensable commodities for sale to China, allow clearer projection of policy to the PRC and within the U.S. Government and allow increased Delegation of Authority to DoC to expedite more cases.

3) ACEP and EDAC shall take action to ensure that all technical data on difficult cases is shared fully and equally before the case is presented to either the ACEP Operating Committee or EDAC Working Group #1.

Rationale

Inefficiencies in the current process due to an incomplete inter-departmental understanding of the technical merits of a case would be eased. Technical differences would be either resolved or sharpened before cases escalate. Interdepartment contact on a more substantive level will hopefully build better communication bridges to help in the final decision process.

4) For those matters requiring case-by-case review, more discipline should be exercised in meeting licensing deadlines. Also, cases should not be returned more than once to an exporter for redraft. A way to achieve this goal would be to have the technology transfer working group (or ACEP and EDAC, as appropriate to the case) meet more often with technical experts from the exporter, instead of relying on written correspondence.

Rationale

Licensing officers desire to work out positive solutions to hard cases, and this can take time. Industry also wants positive results, so they frequently encourage the licensing officer to take more time, and return the application for adjustment and resubmission, rather than accept a denial. Some of this is healthy, but it can get and has frequently gotten out of hand. It should be noted that Congress was sensitive to this problem and specified in the 1978 EAA a 180-day limit for discussion on U.S. licenses, with few

exceptions. COCOM has also adopted a 90-day limit for the consideration of cases though exceptions are allowed for particularly contentious exports.

5) Negotiate a technology transfer memorandum of understanding (MOU) with the Chinese to provide assurances against retransfer of U.S. exports and/or diversion from its originally declared use. The MOU would apply between the levels of routine approval and predisposition of denial. It would be a factor in the case-by-case review process.

Rationale

A technology transfer agreement is seen by many to provide sufficiently increased assurance against retransfer or diversion as to allow significantly increased levels of transfer. We currently have such agreements with several other countries.

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